

Discusses various issues pertaining to corporate purchasing cards, sales tax reporting and audits. See 35 ILCS 105/1 et seq. (This is a GIL.)

April 6, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated October 8, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

This request is the result of questions raised by the users of corporate purchasing cards regarding Illinois' recordkeeping requirements. Many businesses have implemented corporate purchasing card programs to improve the efficiency and reduce the costs of the procurement function. Many of the efficiencies and cost savings associated with the cards are a result of the reduced volume of paper documenting each transaction.

COMPANY and BUSINESS have been working toward helping card users understand the associated sales and use tax issues and develop compliance procedures. To ensure that we are providing the best information possible, we are requesting your response providing guidance on each of the issues described.

In each of the areas identified, a brief statement of the relevant facts is followed by the question. A more detailed statement of the facts is provided in the attachments. The law and regulations pertinent to the issue are provided, the facts are analyzed under the statutory and regulatory requirements, and a conclusion is reached.

I. Adequacy of Level II Data for Documenting Tax Paid

Facts

When a purchasing card is used, certain data is automatically captured by the vendor and will appear on the cardholder's monthly statement. That basic data, commonly referred to as Level I data includes: merchant name and location, merchant category code, cardholder name and location, account number, transaction date and transaction amount. Level I data provides no separate statement of sales tax.

Some suppliers who accept corporate purchasing cards have purchased additional hardware and software to provide enhanced (Level II) data on purchasing card transactions. When a corporate purchasing card is used in a transaction with a Level II-capable vendor, the vendor is prompted at the point of sale to input additional information regarding the transaction. Specifically requested is the amount of sales tax paid on the total transaction and cardholder-supplied information, such as an accounting code or cost center designation, in a discretionary field. It is not possible to report the sales tax paid on each item. Level II data is explained in more detail in the attachments.

Questions

- = Does Level II tax data on the cardholder statement provide adequate sales tax documentation of a purchasing card transaction in lieu of a receipt?
- = If Level II tax data does not provide adequate documentation for all transactions where it is provided, in what situations will it be inadequate, and what additional documentation will be required?

Law

Illinois regulation states a purchaser must have certain information in order to prove use tax was paid to a vendor:

When a user claims that he has paid the Use Tax to his vendor, he will have sufficient records to sustain this contention in case of an examination of his records by the Department if the vendor is registered with the Department as a retailer under the Retailers' Occupation Tax Act or Use Tax Act, and if such user has either a receipt for the Use Tax from the vendor or an invoice from the vendor billing the Use Tax separately from the selling price of the tangible personal property supplemented with proof in the user's records that he has paid such invoice including the Use Tax. (Ill. Admin. Code § 150.1301(a)).

Analysis and Conclusion

As stated in this regulation, Illinois' three requirements for proving tax was paid on an invoice are: 1) separate statement of tax, 2) proof that the vendor is registered under one of the two Tax Acts, and 3) the bill was paid. Level II data meets the first of those requirements: Retailers' Occupation or Use Tax paid is separately stated in a dedicated 'tax paid' field, and the vendor's Illinois registration number can be input in one of the discretionary fields. The third requirement is met by tracing through the accounting records to gain assurance that cardholder statements have been paid. As such, Level II data meets the regulation's requirements and no additional

documentation is required on a transaction where Level II data is provided.

II. Calculation of the Use Tax Accrual Based on the PRODUCT

Facts

To assist purchasing card users identify transactions requiring the accrual of use tax, COMPANY developed a PRODUCT based on the results of the Purchasing Card Best Practices Study. Grounded in accepted use tax accrual principles, the PRODUCT 'filters' transactions through a series of use-tax-driven tests. The end result of the PRODUCT accrual, use tax due, is calculated on those transactions not eliminated as exempt or taxed at the time of sale--the same transactions included in a traditional use tax accrual calculation.

In the PRODUCT, transactions are eliminated from the accrual of use tax based on the following criteria:

- (1) Transactions where the cardholder and vendor are located in the same state are eliminated since sales tax will be charged unless a valid exemption certificate is provided.
- (2) Out-of-state vendors who collect in the cardholder's state are eliminated since sales tax will be charged unless a valid exemption certificate is provided.
- (3) Purchases allocated to account codes representing exempt items, for example, inventory purchased for resale, will also be eliminated.
- (4) Transactions that display Level II tax data are eliminated.
- (5) Transactions of certain cardholders are reviewed by the tax department before they are eliminated.

The remaining transactions are listed in an accrual detail. The transactions are totaled and the use tax accrual is calculated. The PRODUCT is explained in more detail in the attachments.

Question

- = Does the tax accrual methodology described by COMPANY's PRODUCT meet the recordkeeping and reporting requirements for sales and use tax in Illinois?

Law

Recordkeeping requirements for purchasers of tangible personal property for use in Illinois is found in the Use Tax Act (Act 105):

...every person using in this State tangible personal property purchased at retail...shall keep such records, receipts, invoices and other pertinent books, documents, memoranda and papers as the Department shall require, in such form as the Department shall require. The Department may adopt rules that establish requirements, including record forms and formats, for records required to be kept and maintained by taxpayers. (35 ILCS 105 §11).

The Retailer's Occupation Tax Act (Act 120) also grants rulemaking authority regarding recordkeeping and reporting requirements to the Illinois Department of Revenue: '...The Department may adopt rules that establish requirements, including record forms and formats, for records required to be kept and maintained by taxpayers....' (35 ILCS 120 §7).

The provisions of the Retailer's Occupation Tax are applied to the Use Tax by regulation: 'In general, the provisions of various Retailers' Occupation Tax Regulations relative to books and records...shall apply to the subject of books and records under the Use Tax Act.' (Ill. Admin. Code Part 150.1320).

The recordkeeping rules regarding Retailer's Occupation Tax and, therefore, Use Tax are as follows:

a) Every person engaged in the business of selling tangible personal property at retail in this State shall keep records and books...including all sales and purchase invoices, purchase orders, merchandise records and requisitions...as has been the custom in the specific trade, credit memos, debit memos, bills of lading, shipping records, and all other records pertaining to any and all purchases and sales of goods whether or not the retailer believes them to be taxable under the Act; and the retailer shall also keep summaries, recapitulations, totals, journal entries, ledger accounts, accounts receivable records, accounts payable records, statements, tax returns with all schedules or pertinent working papers used in connection with the preparation of such returns, and other documents listing, summarizing or pertaining to such sales, purchases, inventory changes, shipments or other transactions....c) Such books and records must clearly indicate and explain all the information (deductions as well as gross receipts) required for tax returns...(Ill. Admin. Code § 130.801).

Analysis and Conclusion

These statutes and regulations provide guidance for retailers under both the Retailer's Occupation and Use Tax Acts as well as purchasers of tangible personal property for use in Illinois. In their entirety, these recordkeeping requirements are daunting; in their essence

('...shall keep such records, receipts, invoices and other pertinent books, documents...' and '...Such books and records must clearly indicate and explain all the information...required for tax returns...'), they are readily met by the PRODUCT.

To format the information from cardholder statements for clear explanation, the PRODUCT analyzes the record of each purchasing card transaction. It then documents that analysis by categorizing each transaction as either 1) exempt, 2) taxed at the time of sale, or 3) use tax due. The end result of the analysis, the use tax accrual detail, along with the invoices are records and pertinent documents required to 'clearly indicate and explain information' on the tax return.

III. Use Tax Accrual Using PROGRAM Software

Facts

COMPANY has developed a software program, PROGRAM, to help their client companies manage purchasing card programs. One of PROGRAM's components, the NAME is an automated version of the PRODUCT. Thus, the PROGRAM-generated use tax accrual is calculated on those transactions not eliminated as exempt or taxed at the time of sale, the same transactions included in a traditional use tax accrual calculation. A more detailed description of PROGRAM is contained in the attachments.

Question

- = Do the data capture and reporting capabilities of PROGRAM provide adequate documentation to meet the sales and use tax recordkeeping and reporting requirements in Illinois?

Analysis and Conclusion

As noted above, the recordkeeping and reporting requirements found in Illinois statute and regulations are records, receipts, invoices, pertinent books and other documents as may be necessary to explain the information required for the tax return. The PRODUCT's use tax accrual detail coupled with transaction invoices provide the records and documents to explain information on the tax return. Since the PRODUCT is the basis on which PROGRAM is written, the automated version of the model also meets those requirements. By computerizing the PRODUCT, PROGRAM offers the additional advantage of an automated audit trail to efficiently verify decisions made by the software in calculating the use tax due.

IV. Auditing Purchasing Card Transactions

Facts

When Illinois audits companies that use COMPANY's purchasing cards, proof of sales tax paid and use tax accrual calculations are subject to audit scrutiny and recordkeeping requirements as outlined in Illinois laws. A description of an audit approach is contained in the attachments.

Question

- = What audit procedures and document production requirements will be imposed by the taxing jurisdictions when auditing purchasing card transactions?

Law

Illinois statute holds purchasers liable for tax due on taxable purchases, and grants power to the Department of Revenue to audit those transactions.

If the user purchases the tangible personal property at retail from a retailer, but does not pay the Use Tax to such retailer, the purchaser shall pay the Use Tax directly to the Department. (Ill. Admin. Code Part 150.130).

...every person using in this State tangible personal property purchased at retail...shall keep such records, receipts, invoices and other pertinent books, documents, memoranda and papers as the Department shall require, in such form as the Department shall require....the Department, or any officer or employee of the Department designated, in writing, by the Director thereof...may examine any books, papers, records, documents or memoranda of any retailer or purchaser bearing upon the sales or purchases of tangible personal property, the privilege of using which is taxed hereunder...and may take testimony and require proof for its information. (35 ILCS 105 §11).

Analysis and Conclusion

The documents and reports of the PRODUCT's use tax accrual system provide verifiable proof of use tax compliance by an Illinois purchaser. Compliance is fully documented and traceable in the line-item detail of each transaction's categorization as exempt, taxable or use tax due. Such detail provides complete 'proof of its information' in the purchasing card's use tax calculation and accrual. Source documents (such as paper receipts) will be retained only if Illinois has determined that the reports of purchasing card transactions are not adequate to meet Illinois' recordkeeping requirements.

Inherent in the purchasing card use tax accrual is its segregation from other components of the company's use tax accrual process. That calculation should, therefore, be audited separately from other

components of the audit. To audit a purchasing card program, the accounting system would be tested to gain assurance of proper internal control. Once that assurance is gained, a sample from the purchasing card population would be selected and the results projected onto the remainder of the purchasing card population.

V. Purchasing Card Users Agreements With the State

Facts

Successful purchasing card programs have a very high volume of low-dollar transactions. Taxing agencies have found these programs to be excellent candidates for 'managed audits' in which the taxing agency oversees and directs the audit of a company utilizing the audited company's personnel to perform the majority of the fieldwork tasks. The tasks performed by the audited company's personnel are subject to review and adjustment by the auditor.

Question

- = Does Illinois have the statutory authority to enter into agreements with companies to conduct a managed audit of the purchasing card program's use tax accrual?

Law

The authority to audit an Illinois purchaser's records is found in Illinois statute:

...every person using in this State tangible personal property purchased at retail...shall keep such records, receipts, invoices and other pertinent books, documents, memoranda and papers as the Department shall require, in such form as the Department shall require. For the purpose of administering and enforcing the provisions hereof, the Department, or any officer or employee of the Department designated, in writing, by the Director thereof, may hold investigations and hearings concerning any matters covered herein and may examine any books, papers, records, documents or memoranda of any retailer or purchaser bearing upon the sales or purchases of tangible personal property, the privilege of using which is taxed hereunder, and may require the attendance of such person or any officer or employee of such person, or of any person having knowledge of the facts, and may take testimony and require proof for its information. (35 ILCS 105 §11).

Analysis and Conclusion

This statute grants the Department of Revenue board discretion to audit Illinois taxpayers. We infer from this broad power that the department has discretion to enter into 'managed audit' programs so

long as the audit provides 'proof for its information.' The high-volume low-dollar transactions of a purchasing card system are well suited for 'managed audits. To effectively use resources of the Department of Revenue, it is in their interest to exercise their discretionary authority and employ this alternative method of auditing.

* * * * *

I have enclosed additional information on each of the issues to provide you with background on the work COMPANY has done in the sales and use tax area. I will give you a call next week after you have had an opportunity to review this request. If you have any questions prior to that, please give me a call at #####.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Illinois Retailers' Occupation Tax Act, 35 ILCS 120/1 et seq., imposes a tax on Illinois retailers measured by a percentage of their gross receipts from sales for use or consumption. The Illinois Use Tax Act, 35 ILCS 105/1 et seq., imposes a tax on the purchaser by taxing the use of tangible personal property purchased from a retailer.

Illinois sales tax laws require that retailers shall collect the Use Tax from users by adding the tax to the selling price of tangible personal property. The Use Tax shall be stated as a distinct item separate and apart from the selling price of the tangible personal property. See 35 ILCS 105/3-45 and the enclosed copies of 86 Ill. Adm. Code Sections 150.401 and 150.1305.

Certain problems are presented when sales records do not describe items purchased, and tax is reported in "total transaction" amounts. For example, in Illinois, there are multiple tax rates. Generally, tangible personal property is subject to the State rate of tax, 6.25% plus applicable local taxes. However, food, drugs, medicines and medical appliances are subject to a reduced rate of tax, 1% plus applicable local taxes. The total tax amount stated on the billing statement would reflect one tax amount and not differentiate between high rate and low rate items. In addition, certain items of tangible personal property may be purchased free from tax; however, the billing statement would not reflect the specific exemption claimed by the purchaser. Unless records are available to establish that items purchased were subject to the lower rate of tax, or to document the exemption, tax will be due.

The Legal Services Office has discussed corporate purchasing card sales tax reporting with the Audit Bureau. It is the Audit Bureau's position that any and all information relating to corporate purchasing card sales tax reporting must remain subject to audit verification upon request.

Regarding accrual methods of estimating Use Tax due, such methods can be useful for businesses, whether performed manually or with the aid of software programs. Nevertheless, these methods provide only estimates of tax due. This should not be confused with the necessity of documenting actual amounts of tax

due and tax paid. In an audit setting, estimates are always subject to verification. Therefore, while accrual methods of estimating tax may be used, tax liability will be assessed if the method yields inaccurate results.

As you mentioned, the statutes provide the Department with broad powers to conduct audits. It is the Department's opinion that this includes such diverse methods of auditing as sampling, computer assisted auditing, and managed audits.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Encl.